No. 17-130

In The Supreme Court of the United States

RAYMOND J. LUCIA, ET AL.,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION

On Writ of Certiorari to the
United States Court of Appeals
for the District of Columbia Circuit

BRIEF OF THE NEW CIVIL LIBERTIES ALLIANCE AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether administrative law judges of the Securities and Exchange Commission are Officers of the United States within the meaning of the Appointments Clause.

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BRIEF OF THE NEW CIVIL LIBERTIES ALLIANCE AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF AMICUS[1]

The New Civil Liberties Alliance (NCLA) is a nonprofit, public-interest law firm founded to challenge multiple constitutional defects in the modern administrative state through original litigation, amicus curiae briefs, and other means. The "civil liberties" of the organization's name include rights at least as old as the U.S. Con-

1. All parties consented to the filing of this brief. No counsel for a party authored any part of this brief. And no one other than the amicus curiae, its members, or its counsel financed the preparation or submission of this brief.

stitution itself, such as jury trial, due process of law, and the right to be tried in front of an impartial and independent judge whenever the government brings cases against private parties. Yet these selfsame civil rights are also very contemporary—and in dire need of renewed vindication—precisely because the Securities and Exchange Commission (SEC) and other administrative agencies have trampled them for so long.

NCLA aims to defend civil liberties—primarily by asserting constitutional constraints on the administrative state. Although Americans still enjoy the shell of their Republic, there has developed within it a very different sort of government—a type, in fact, that the Constitution's design sought to prevent. This unconstitutional state within the Constitution's United States is the focus of NCLA's concern.

Administrative rulemaking shifts much lawmaking from elected legislators to unelected bureaucrats, thereby removing it from a diverse people, placing it into the hands of a relatively homogenous few, and depriving Americans the benefit of equal voting rights. While this Court once justified the administrative adjudication of private rights as "prompt, continuous, expert, and inexpensive,"[2] this is no longer an apt description. Rather, at the SEC and elsewhere, administrative adjudication is often slow (as when Commissioners conduct appellate review), parochial (as when ALJs are barred from considering constitutional objections), inexpert (as detailed in the Argument below), and, of course, financially bur-

2. *Crowell v. Benson*, 285 U.S. 22, 46 (1932).

densome. To top it off, such adjudication violates procedural rights guaranteed by the Constitution.

The structural costs are severe. By giving the enforcement agency a second path for enforcement, administrative adjudication transforms procedural rights from constitutional guarantees into mere options for the exertion of governmental power. Perhaps worst of all, judicial deference to administrative interpretation and fact-finding corrodes the very judicial processes charged with keeping the Constitution's structural safeguards intact. For all these reasons, administrative power is the single greatest threat to civil liberties in our time.

NCLA agrees with the petitioners and the Solicitor General that administrative-law judges (ALJs) are "officers of the United States" subject to the Constitution's appointment rules. This amicus brief, however, underscores a key point about the *lack* of independence that ALJs enjoy. As the brief amply demonstrates, upholding the double-layered appointment of SEC ALJs would not protect their independence—in large part because they have very little independence to begin with under the current appointment regime. Hence, the Court can safely disapprove the existing appointment system without worrying about undermining ALJ independence.

STATEMENT OF FACTS

A. SEC's Appointment Process for ALJs

The SEC's administrative-law judges are sometimes—but not always—selected from a list of eligible candidates produced by the Office of Personnel Management (OPM). Pet. App. 295a–297a. OPM assembles

its list of eligible candidates after administering a competitive examination to aspiring ALJs. *See* 5 C.F.R. § 930.201(d)–(e). The SEC's chief administrative-law judge, along with an interview committee, considers the top three candidates on OPM's list and recommends one of them to serve as an ALJ. *See* 5 U.S.C. §§ 3317, 3318; 5 C.F.R. §§ 332.402, 332.404. This recommendation is subject to final approval by the SEC's Office of Human Resources. Pet. App. 297a.

Although it is commonly assumed that all SEC ALJs are appointed through this OPM process, *see* Pet. Br. 4 ("SEC ALJs are selected by SEC staff from a list of three candidates provided by the Office of Personnel Management."), that is not always the case. Sometimes the SEC does not want to limit itself to the three names produced by OPM, and it is allowed to circumvent this OPM process by hiring individuals who already serve as ALJs in other agencies. *See* 5 C.F.R. § 7.1; 5 C.F.R. § 315.501; Recommendations and Statements of the Administrative Conference Regarding Administrative Practice and Procedure, 57 Fed. Reg. 61760, 61761 (December 29, 1992) ("[M]ost agencies in recent years have found ways to circumvent this [OPM] process somewhat, primarily by hiring laterally from other agency ALJ offices."); Paul H. Verkuil, et al., *Administrative Conference of the United States Recommendations and Reports*, 1992 ACUS 942 ("The most prevalent way of circumventing the [OPM] register, however, is through 'lateral hiring'—transfer of ALJs between agencies.... OPM has recognized that this could provide some 'gaming' of the system."); Draft Report, American Bar Asso-

ciation, *Administrative Law Judges Under the Federal Administrative Procedure Act* (February 13, 2001), available at http://bit.ly/2GO9Kan (last visited on February 28, 2018) ("Agencies often prefer to avoid hiring ALJs off [OPM's] register. Instead, they hire ALJs laterally from other agencies. Lateral transfers are allowed after an ALJ has served at least one year in the agency making the original hire."). This practice enables the SEC to search for the most favorable candidates from among the 1,700 ALJs employed by the Social Security Administration (SSA), along with the countless number of ALJs who work for other federal agencies, rather than limiting itself to the three names on OPM's list. Indeed, three of the five SEC administrative-law judges—Brenda Murray, Carol Foelak, and Cameron Elliot—served as ALJs at other federal agencies before beginning their SEC stints.

The Enforcement Division has refused to say whether ALJs Murray and Elliot were hired through the OPM process. In a recent case involving Timbervest LLC, the Commission ordered the Enforcement Division to file an affidavit "setting forth the manner in which ALJ Cameron Elliot and Chief ALJ Brenda Murray were hired, including the method of selection and appointment."[3] The Enforcement Division responded with a cryptic statement that "ALJ Elliot was not hired through a process involving the approval of the individual members of the

3. *See* https://www.sec.gov/litigation/opinions/2015/ia-4096.pdf (last visited on February 28, 2018).

Commission."[4] The Division also filed an unsworn "Notice of Filing" that described the OPM process and stated that "[i]t is the Division's understanding that the above process was employed as to ALJ Elliot."[5]

But it is clear that the SEC did not follow the OPM process when it hired Cameron Elliot. Mr. Elliot himself has admitted as much. *See* Notice, http://bit.ly/2CprDyj (last visited on February 28, 2018) ("[D]uring a hearing in another case . . . ALJ Elliot expressed his belief that, because he transferred to his current position from the Social Security Administration, he was hired pursuant to a different process from that described in the Division's Notice of Filing."). So the SEC has far more control over the hiring process for ALJs than is typically assumed.

B. SEC's Proceedings Against Mr. Lucia

Petitioner Raymond J. Lucia is an investment professional who for nearly 40 years has had an unblemished record in his chosen profession. Mr. Lucia held free seminars for prospective clients that touted a retirement-planning strategy called "Buckets of Money," which urged a diversified portfolio from which investors would first liquidate lower-risk investments, while allowing the riskier investments more time to grow. Pet. App. 23a, 34a, 119a–120a, 127a–129a, 233a.

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4. *See* Affidavit of Seidman, https://www.sec.gov/litigation/apdocuments/3-15519-event-139.pdf (last visited on February 28, 2018).
5. *Ibid.*

Mr. Lucia used a slideshow that compared the outcomes for hypothetical investors who followed his strategy with those who followed other approaches. Two of the 126 slides in his slideshow were described as "backtests," which used actual historical data for stock-market returns alongside hypothetical assumptions regarding inflation and rates of return on real-estate and non-stock investments. All of the slides showing examples—including the two "backtest" slides—contained prominent disclaimers such as "This is a hypothetical illustration and is not representative of an actual investment." Pet. App. 43a n.10, 45a n.14, 47a n.19.

Mr. Lucia's slideshow was reviewed prior to public distribution by broker-dealers registered with the Financial Industry Regulatory Authority, who approved the slides and raised no concerns. Pet. App. 84a. And in 2003, SEC staff reviewed a similar presentation of Mr. Lucia's without raising any concerns that it might mislead. *Ibid.* No securities were offered or sold at Mr. Lucia's presentations, and none of the nearly 50,000 investors who have attended the seminars has ever filed a complaint alleging that the slides were misleading. Pet. App. 39a n.2, 82a, 129a, 206a.

Nevertheless, in 2012, the SEC charged Mr. Lucia with violating the antifraud provisions of the Investment Advisor's Act and SEC rules. The SEC claimed that Mr. Lucia had broken the law by using the word "backtest" when describing returns that combined actual historical data for stock-market returns with hypothetical assumptions about inflation and returns on non-stock investments during that time period. Pet. App. 7a-8a, 66a. Alt-

hough the word "backtest" is undefined in the law and in SEC regulations, and it had never before been construed in any judicial or administrative proceeding, the SEC's Enforcement Division insisted that a "backtest" must rely *exclusively* on historical data—even when a presentation explicitly discloses that hypothetical assumptions are being used. C.A.D.C. en banc JA 30.

The SEC had the option of bringing its enforcement action in federal court before an impartial and independent Article III judge who enjoys life tenure and salary protection. Instead, the SEC eschewed the Article III process and sued Mr. Lucia in its own administrative forum, where respondents have no right to a jury, a sharply curtailed right to discovery, and where the Federal Rules of Evidence are inapplicable. *See* Jean Eagleshem, *CFTC Turns Toward Administrative Judges*, Wall St. J. (November 9, 2014), http://on.wsj.com/2oDxXIX ("'We are going to use administrative proceedings more often,' [SEC Enforcement Director Andrew] Ceresney said. That will include some complicated cases, such as insider trading, that were once almost invariably tried in federal court, according to officials."). The case was assigned to ALJ Cameron Elliot, who has overwhelmingly ruled in favor of the Enforcement Division throughout his tenure, *see infra*, at 17, and who (unsurprisingly) found for the Commission and against Mr. Lucia in this case.

Asymmetries abound in these administrative proceedings. The SEC can spend years in burdensome investigations, *see* 15 U.S.C. § 78u(a)(1), yet respondents are generally allowed "approximately four months" for

limited discovery with little or no depositions. *See* 17 C.F.R. §§ 201.360(a)(2)(ii); 201.233(a). ALJs have broad discretionary powers to admit or exclude evidence, and they make factual and legal determinations that can be accepted without review or question by the Commission. And if no timely petitions for review are filed, or if the Commission declines review, an ALJ's decision "shall, for all purposes, including appeal or review thereof, be deemed the action of the Commission." 15 U.S.C. § 78d-1(c); accord 5 U.S.C. § 557(b) (ALJ's "initial decision" automatically becomes final "without further proceedings" absent further review.).

ALJ Elliot conducted a nine-day hearing, presiding over witness testimony and cross-examination. The ALJ made an initial finding of fraudulent misrepresentation on one investment strategy, but did not make factual findings on the SEC's remaining claims. Pet. App. 117a. The Commissioners then remanded the case back to the ALJ for fact-finding on the three remaining claims, noting the "vital role that initial decisions play in the Commission's decisional process." Pet. App. 241a. The Commission explained that the ALJ's determinations on the remaining claims would have "considerable importance" because the Commission itself had not "observed the parties and the witnesses." Pet. App. 241a.

On remand, the ALJ issued a revised initial decision finding that Mr. Lucia had willfully and materially misled investors and ordering draconian sanctions. He revoked Mr. Lucia's registration as a securities advisor; permanently barred him from associating with investment advisors, brokers, or dealers (including his own son); and

ordered more than $300,000 in civil monetary penalties. Pet. App. 225a–233a, 235a.

In reaching this decision, ALJ Elliot specifically credited the testimony of two witnesses—one of whom had admitted in writing that he knowingly made false statements against Lucia in an arbitration claim brought before the Financial Industry Regulatory Authority, while the other was described by the ALJ as having "holes in his memory." Pet. App. 193a-194a. At the same time, the ALJ never heard the proffer of evidence from other witnesses favorable to Mr. Lucia, as those pro-Lucia witnesses were intimidated into withdrawing by late-night subpoenas issued by SEC's Enforcement Division demanding all of their financial records, in every format, from any source, over a five-year period. Pet. Br. 7.

There was no evidence and no finding that any investor suffered any loss from the backtest marketing materials. Pet. App. 101a. Instead, ALJ Elliot cited "the substantial financial success" that Mr. Lucia and his company had supposedly "enjoyed at their clients' expense." Pet. App. 231a.

The Commission affirmed the ALJ's decision, over dissent, after Mr. Lucia sought review. The dissenting Commissioners—in the only written dissent of 2015—accused the majority of "creat[ing] from whole cloth specific requirements for advertisements that include the word 'backtest.'" Pet. App. 111a. The D.C. Circuit denied Mr. Lucia's petition for review after concluding that the SEC's liability findings were supported by substantial

evidence, and that the sanctions imposed were not an abuse of discretion. Pet. App. 21a–36a.

SUMMARY OF ARGUMENT

The petitioners and the Solicitor General have capably explained why SEC administrative-law judges qualify as "officers of the United States," who must be appointed in accordance with the process described in Article II of the Constitution. *See* Pet. Br. at 11–42; Resp. Br. at 10–38. NCLA writes as amicus to explain that the ostensible rationale for departing from the Constitution's appointment process—a desire to produce "independent" administrative-law judges—is inapplicable in this case, as the SEC's appointment process has failed to secure independent adjudication in any meaningful sense of the word.

SEC ALJs face significant institutional pressures to conform to the Commission's enforcement policy preferences. Not only must SEC ALJs follow agency rules, interpretations, and policies, but they also lack subject-matter expertise when appointed. This lack of prior expertise makes SEC ALJs vulnerable to pro-agency bias of various kinds, which they may not even recognize given how the bias is baked into agency precedent.

Avoiding the Appointments Clause has produced neither independence nor expertise among ALJs—quite the contrary. Hearings in front of ALJs at the SEC nowadays are neither impartial nor particularly expert. There is no reason for this Court to fear that declaring administrative-law judges to be "officers of the United States" will undermine the independence (or expertise) of agency adjudication, because the SEC's administra-

tive-law judges are short of independence and expertise to begin with. More effective and constitutionally permissible paths are available to secure independent judges in SEC proceedings.

ARGUMENT

I. The Current Appointment Process Does Not Secure the Independence of Administrative-Law Judges

SEC administrative-law judges have no institutional independence from the Commission, and the convoluted process for appointing these judges therefore does not further the goal of independent adjudication. ALJs face institutional pressures to favor SEC positions in enforcement proceedings; they are forbidden to question the legality or propriety of SEC rules and interpretations of statutes; and they do not conduct their hearings in an impartial and independent manner.

A. SEC ALJs Operate Under Institutional Pressures to Conform to the SEC's Wishes

The double-layered method of appointing SEC administrative-law judges does not secure their independence. Once appointed, the ALJs know that their decisions are subject to SEC review—and that the SEC can review their decisions on its own initiative when the losing party declines to appeal. *See* 17 C.F.R. §§ 201.410, 201.411(c). The ALJs must comply with the wishes of their overseers or face near certain reversal.

The ALJs also know that their cases are brought by the SEC in its prosecutorial role. So the Commission

that *appears before* an ALJ as a litigant will also be *reviewing* the ALJ's decisions. In every case, the ALJs must rule upon claims and arguments brought by the same entity that can review and reject or ultimately adopt their decisions.

Finally, the ALJs know that the SEC almost always decides in its own favor. From October 2010 through March 2015, the SEC ruled in the agency's favor in 95% of appeals taken from ALJ decisions. *See* Gideon Mark, *SEC and CFTC Administrative Proceedings*, 19 U. Pa. J. Const. L. 45, 48 (2016); Jean Eaglesham, *SEC Wins with In-House Judges*, Wall St. J. (May 6, 2015), http://on.wsj.com/1AKOxEH.

Under these circumstances, the ALJs have reason to issue rulings that anticipate their superiors' prosecutorial desires. This is not to suggest that the ALJs are deliberately biased in favor of the SEC, only that they face strong institutional pressures to align their decisions with SEC preferences.

One might protest that inferior Article III judges also dislike being overruled, and that the availability of review does not diminish their independence. But SEC ALJs are in a different position. They issue only initial decisions. *See* 17 C.F.R. § 201.360(a)(2). And if their decisions do not satisfy the prosecuting party, their decisions will not become final, and the prosecuting party will substitute its own decisions. *See* 15 U.S.C. § 78d-1; 17 C.F.R. §§ 201.410, 201.411(c). SEC ALJs therefore cannot even expect to have their decisions become final, unless they reach the results desired by the prosecuting party.

ALJs face other incentives to conform to the SEC's wishes. Their dockets, their prospects of promotion, and their future employment are subject to SEC control, and the Commission can wield its powers in a manner that rewards agency-friendly judges. For example, pending oversight from the Merit Systems Protection Board, the SEC can remove, suspend, demote, or reduce the salaries of ALJs for "good cause." 5 U.S.C. § 7521. Although a charge of good cause cannot be "base[d] on reasons which constitute an improper interference with the ALJ's performance of his quasi-judicial functions," *Brennan v. Dep't of Health & Human Servs.*, 787 F.2d 1559, 1563 (Fed. Cir. 1986), this nonetheless leaves room to remove and otherwise penalize ALJs for conduct "inconsistent with maintaining confidence in the administrative adjudicatory process," *Long v. Soc. Sec. Admin.*, 635 F.3d 526, 536 (Fed. Cir. 2011), including "adjudicatory errors" over a range of cases. *Social Sec. Admin., Office of Hearings and Appeals v. Anyel*, M.S.P.B.1993, 58 M.S.P.R. 261, 268–69, opinion after remand 66 M.S.P.R. 328 (finding "good cause" in an ALJ's "adjudicatory errors" and in her "'[i]ndependence' consisting of freedom to ignore binding agency interpretations of law").

ALJs know that they can pay a price for deviating too much from the SEC's expectations, and at least one SEC ALJ has protested that she was admonished.[6] They can-

6. *See* Jean Eaglesham, *SEC Wins with In-House Judges*, Wall St. J. (May 6, 2015), http://on.wsj.com/1AKOxEH (reciting complaints of former ALJ Lillian McEwen), detailed in Part I.C below.

not help but be aware of the ALJ purge that occurred at the U.S. Commodity Futures Trading Commission ("CFTC"). That agency abandoned its long-held preference for administrative adjudication after an "almost decade-long losing streak before one of its own ALJs" prompted the change.[7] The CFTC thereafter eliminated two ALJs and their associated staff, and terminated one ALJ through a reduction-in-force (RIF) in 2012.[8] Reduction in force is an exception to the "good cause" requirement for removing ALJs, *see* 5 U.S.C. § 7521(b), meaning that an agency can simply clear its decks of unwanted ALJs. *See* Federalist, No. 79 (Hamilton) ("In the general course of human nature, a power over a man's subsistence amounts to a power over his will."). Conversely, compliant ALJs can be rewarded for their loyalty, as the SEC recently demonstrated in its November 30, 2017, order ratifying and reappointing its five agency-friendly ALJs.[9]

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7. Gideon Mark, *SEC and CFTC Administrative Proceedings*, 19 U. Pa. J. Const. L. 45, 60 (2016).

8. GAO Letter of January 23, 2013, available at https://www.gao.gov/assets/660/651588.pdf (last visited on February 28, 2018).

9. On November 30, 2017, the day after the Solicitor General submitted a brief in this case taking the position that the SEC's ALJ appointments were inconsistent with the Constitution's Appointments Clause, the SEC issued an official Press Release announcing that the Commission "has ratified its prior appointment of Chief Administrative Law Judge Brenda Murray, and Administrative Law Judges Carol Fox Foelak, Cameron Elliot, James E. Grimes and Jason S. Patil." *See* https://www.sec.gov/news/press-release/2017-215 (last visited on February 28, 2018). The press release further asserted: "By ratifying the appoint-

(continued...)

B. SEC ALJs Must Follow Agency Rules, Interpretations, and Other Policies

When the SEC litigates in an Article III forum, the court may—indeed, must—review the legality of the agency's rules, its interpretations of statutes, and its other policies and pronouncements. *See* 5 U.S.C. § 706 (instructing courts to "hold unlawful and set aside agency action, findings, and conclusions found to be" unlawful). As Chief Justice Marshall explained, "It is emphatically the province and duty of the judicial department to say what the law is. Those who apply the rule to particular cases, must of necessity expound and interpret that rule. If two laws conflict with each other, the courts must decide on the operation of each.... This is of the very essence of judicial duty." *Marbury v. Madison*, 5 U.S. 137, 177 (1803).

Not so in agency adjudication, where the SEC's administrative-law judges are forbidden to depart from or question the legality of the agency's rules—even if the defendant is challenging their validity. *See Arizona Grocery Co. v. Atchison*, 284 U.S. 370 (1932). Worse, the ALJs are also forbidden to consider challenges to the lawfulness or validity of the SEC's organic statutes. *See Milton J. Wallace*, Exchange Act Release No. 11252, 1975 SEC Lexis 2238, at *7 (February 14, 1975) (declar-

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ment of its ALJs, the Commission has resolved any concerns that administrative proceedings presided over by its ALJs violate the Appointments Clause. The Commission Order also directs the ALJs to review their actions in all open administrative proceedings to determine whether to ratify those actions." *Ibid.*

ing that the SEC (and thus an SEC ALJ) has "no power to invalidate the very statutes that Congress has directed [it] to enforce."). So the ALJs' hands are partially tied whenever they adjudicate an enforcement proceeding. And this gives the SEC a built-in advantage whenever it brings enforcement actions before its ALJs.

C. SEC ALJs Do Not Conduct Hearings in an Impartial and Independent Manner

The SEC contends that its ALJs "conduct public hearings in a manner similar to federal bench trials." SEC, Office of Administrative Law Judges (page last modified January 26, 2017), at https://www.sec.gov/alj. Much evidence casts doubt on this assertion.

To begin, the SEC's rate of success before its ALJs is considerably higher than its rate of success in federal court. From October 2010 to September 2015, the SEC "prevailed against 86% of respondents in contested cases heard by ALJs" but "had a considerably lower success rate of 70% in federal court." Gideon Mark, *SEC and CFTC Administrative Proceedings*, 19 U. Pa. J. Const. L. 45, 47 (2016). Indeed, the SEC ALJ who presided in Mr. Lucia's case has demonstrated an astonishing record of fealty to his agency. *See* Jean Eaglesham, *Fairness of SEC Judges Is in Spotlight*, Wall St. J. (November 22, 2015) ("Judge Cameron Elliot, a 49-year-old former nuclear-submarine officer and SEC judge since 2011, has found the defendants liable in every contested case he has heard, the analysis showed.... Mr. Elliot told the defendants during settlement discussions on a case they should be aware he had never ruled against the agency's enforcement division").

None of these data or anecdotes should be surprising. In a 1992 survey of ALJs, 15 percent complained of threats to their independence, while 9 percent reported that threats of this sort were a frequent problem. *See* Charles H. Koch Jr., *Administrative Presiding Officials Today*, 46 Admin. L. Rev. 271, 278 (1994). One of the SEC's former administrative-law judges has publicly complained that she had been pressured to reach decisions favorable to the Commission. *See* Jean Eaglesham, *SEC Wins with In-House Judges*, Wall St. J. (May 6, 2015), http://on.wsj.com/1AKOxEH ("Lillian McEwen, who was an SEC judge from 1995 to 2007, said she came under fire from Ms. Murray [the SEC's chief administrative-law judge] for finding too often in favor of defendants. 'She questioned my loyalty to the SEC,' Ms. McEwen said in an interview, adding that she retired as a result of the criticism."). Chief ALJ Murray remains on the job.

Finally, administrative-law judges can reverse the burdens of proof. When litigating enforcement actions in an Article III forum, the SEC must always bear the burden of proof on disputed questions of fact—and in criminal proceedings the SEC must prove its case beyond a reasonable doubt. *See In re Winship*, 397 U.S. 358, 364 (1970).

ALJs, however, can reverse such burdens by taking "official notice" of facts. 5 U.S.C. § 556(e). Unlike federal district-court judges, who are confined to the evidence introduced by the parties and face strict limits on taking

"judicial notice" of facts outside the record,[10] SEC ALJs can take notice of any material fact—regardless of whether it appears in the record, is adjudicative, falls within the expertise of the agency, or is subject to reasonable dispute. *See* SEC Rules of Practice, § 111, at https://www.sec.gov/about/rulesprac072003.htm#323 ("No provision of these Rules of Practice shall be construed to limit the powers of the hearing officer provided by the Administrative Procedure Act, 5 U.S.C. §§ 556, 557."). Worse, an ALJ can do all of this without a hearing, which is available to parties whenever a district-court judge takes judicial notice of facts. *See* Fed. R. Evid. 201(e) ("On timely request, a party is entitled to be heard on the propriety of taking judicial notice and the nature of the fact to be noticed. If the court takes judicial notice before notifying a party, the party, on request, is still entitled to be heard."). ALJs thus have a sweeping power to take notice even of disputed facts. To be sure, when an ALJ takes notice of facts, a defendant can ask the ALJ for "an opportunity to show the contrary." 5 U.S.C. § 556(e). But the effect is to shift the burden of proof to the defendant, who now must introduce evidence to *disprove* facts of which the ALJ has taken "official notice."[11]

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10. *See* Fed. R. Evid. 201(b) ("The court may judicially notice a fact that is not subject to reasonable dispute because it: (1) is generally known within the trial court's territorial jurisdiction; or (2) can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned.").

11. Not merely when SEC ALJs take notice of facts, but throughout their proceedings, they are said to reverse the burden of

(continued...)

In one way after another, ALJs at the SEC lack the requisite impartiality and independence under the current appointment regime. Nothing will be lost by disapproving this mode of appointment.

II. Lack of Prior Background or Expertise in Securities Law Renders SEC ALJs Vulnerable to Agency Bias and Influence

A. SEC's ALJs Lack Prior Securities Law Expertise

Defenders of agency tribunals sometimes assert that administrative-law judges have (or develop) special expertise in the legal issues and subject matter of their agency—and that the benefits of this expertise outweigh the pathologies that arise from administrative adjudication. *See, e.g.*, Gideon Mark, *SEC and CFTC Administrative Proceedings*, 19 U. Pa. J. Const. L. 45, 117 (2016) (arguing that one of the "countervailing benefit[s] of administrative adjudication" before the SEC derives from its "agency ALJs who develop an expertise in the federal securities laws"). But the SEC's ALJs do not appear to have had *any* background in securities before their appointments, and the publicly available résumés of these individuals evince no previous experience in the field.

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proof. *See* Jean Eaglesham, *SEC Wins with In-House Judges*, Wall St. J. (May 6, 2015), http://on.wsj.com/1AKOxEH (quoting a former SEC administrative-law judge who alleged that "the burden was on the people who were accused to show that they didn't do what the agency said they did.").

The most recent SEC administrative-law judge, appointed in September 2014, worked in the U.S. Department of Justice from 1998 to 2012 as an attorney in the Executive Office for Immigration Review and as a trial attorney litigating civil cases, including litigation surrounding the anthrax letter attacks and involving the World Trade Center site post-9/11. He also spent time in Egypt and Iraq as a government attorney.[12]Another SEC ALJ, who was appointed in June 2014, previously spent 13 years in the U.S. Department of Justice as senior litigation counsel in the civil division and worked in the U.S. Navy's Judge Advocate General's Corps, first as a trial defense counsel for service members facing court-martial and later as an appellate counsel representing the government before military appellate courts.[13]

An ALJ appointed in April 2011 appears to have previous service as an ALJ for the Social Security Administration, some years of practice of intellectual-property law, service as an assistant U.S. Attorney in the Southern District of Florida and the Eastern District of New York, and work as a trial attorney in the U.S. Department of Justice, where he handled patent and copyright cases.[14]

The biographies for the two longest-tenured ALJs appointed in the 1990s do not appear anywhere on the

12. *See* https://www.sec.gov/news/press-release/2014-208 (last visited on February 28, 2018).

13. *See* https://www.sec.gov/news/press-release/2014-129 (last visited on February 28, 2018).

14. *See* https://www.sec.gov/news/press/2011/2011-96.htm (last visited on February 28, 2018).

SEC's website. Chief ALJ Brenda Murray's bio was published in conjunction with her appearance at a 2015 conference on "Women, Prison, and Gender-Based Violence," and (like those of her colleagues) it does not reveal any background or prior experience in securities law.[15] The final ALJ spent 29 years as a staffer at the Federal Communications Commission before becoming an ALJ at the Social Security Administration and then a short time later an ALJ at the SEC.

B. A Lack of Prior Expertise Makes It Harder for ALJs to Resist Sources of Pro-Agency Bias

ALJs who lack any background or experience in securities law before joining the agency will be more susceptible to SEC influence. A securities-law novice will be far more reluctant than a seasoned expert to second-guess or stand up to the Commission's enforcement efforts. Such trepidation further aggravates the independence problems that afflict SEC's in-house adjudication regime.

One source of potential bias derives from the blinders that ALJs are forced to wear. Unlike Article III judges, ALJs at the SEC (and elsewhere) are not allowed to question the constitutionality or legality of the laws or regulations they adjudicate. They must ignore any claims by a defendant that an authorizing statute violates the Constitution (whether on its face or as applied),

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15. *See* http://www.lawschool.cornell.edu/womenandjustice/Conferences-and-Events/upload/2015-Conference-Bios-FINAL-2.pdf (last visited on February 28, 2018).

and they may not pass judgment on whether a regulation is authorized by statute. By routinely ignoring claims of this sort, the ALJs can become desensitized to the agency's error rate, and can wind up viewing the agency as closer to infallible than it really is. This misperception is especially likely to occur when an ALJ's only experience with SEC cases comes while sitting as an ALJ. Because federal district-court judges are not similarly constrained in the arguments that they may consider, they do not risk having their perception skewed in this manner. The unquestioned allegiance that ALJs must display toward the SEC's statutory and regulatory regime no doubt contributes to the higher success rates that the Enforcement Division enjoys before its ALJs as compared to federal district-court judges.

A second source of bias arises from the ratchet effect of the Commission's appellate review. The Enforcement Division almost invariably appeals to the Commission when it loses before an ALJ. In contrast, defendants increasingly do not appeal adverse ALJ rulings, for reasons of expense and futility. Furthermore, when the Commission reviews an ALJ judgment, it is highly likely to adopt the Enforcement Division's position—after all, the Commissioners were the ones who approved the enforcement case and the underlying enforcement policies. So ALJ decisions in the Commission's favor are rarely overruled on appeal, while ALJ decisions in a defendant's favor are much more likely to be reversed by the Commission. Over time this means that outlier legal rulings in the defendant's favor are far more likely to be corrected than erroneous ones favoring the SEC. This

lopsided review mechanism leads to an undue accretion of pro-SEC rulings, which virtually ensures that the Commission's precedents will be stretched in the agency's favor. This biased body of SEC precedent also becomes part of the agency knowledge that new ALJs encounter when they first join the agency, and from which they acquire their expertise in securities law. When they do not bring their own prior subject-matter expertise with them, they are not well equipped to recognize or overcome the biased effect of the agency precedents.

Yet another source of bias arises from the fact that many ALJs—including the judge who presided in this case—are hired from the pool of Social Security Administration ALJs. *See* Draft Report, American Bar Association, *Administrative Law Judges Under the Federal Administrative Procedure Act* (February 13, 2001), available at http://bit.ly/2GO9Kan (last visited on February 28, 2018) ("Approximately 900 of the 1,200 ALJs hear benefits cases for the SSA. Therefore, most agencies prefer to hire from the abundance of experienced SSA ALJs, rather than hiring off a strict register. As a result, only the SSA significantly relies on the OPM selection process to hire their ALJs."). SSA judges determine eligibility for government benefits, and in this context, the burden of proof appropriately lies with the claimant, and the government's success rate is understandably high. In contrast, in SEC adjudications—where the government is charging defendants with violations of law and is threatening to deprive them of their livelihood, future employment, and reputation, and to impose severe financial penal-

ties—the burden of proof should be on the government. But ALJs accustomed to ruling for the government may not give defendants their due. Former SSA judges, in particular, are apt to adjudicate the binding constraints at stake in SEC cases as if they were akin to benefits at stake in SSA cases.[16] Where an ALJ lacks prior subject-matter expertise—and thus familiarity with binding constraints and rights-based defenses—there is a further danger of bias in the agency's favor.

There is reason to think that SEC is aware of the factors that could lead ALJs to favor the agency. As discussed above, the Commission has often skipped the OPM merit selection process in favor of plucking its ALJs directly from the pool of ALJs at other agencies. Why does it do this? And given that it thereby greatly expands the pool of candidates, why does it nonetheless select candidates who do not bring subject-matter expertise with them? There is at least the possibility that the SEC has learned that it is better able to identify ALJs who have a propensity for (or track record of) favoring the government when it uses this selection method.

Selecting ALJs directly from other agencies further undercuts the independence of all ALJs, because by now a majority of the ALJs at the SEC has been appointed in this way. When the Enforcement Division brings a case in front of these judges—none of whom has a securities-

16. This difference—between ALJs who adjudicate benefits and ALJs who adjudicate binding constraints—also forms the basis for a valid and workable distinction, under which the Appointments Clause applies in the SEC adjudication context, even if not necessarily in benefits-adjudication contexts.

defense background—it does not have to worry as it would in federal district court about drawing a judge who might embarrass the Commission by ridiculing a far-fetched legal theory or weak case propounded by the Enforcement Division. This fact alone affects the cases SEC is willing to bring, the legal interpretations it is prepared to advance, and the extent to which it will warp the law in pursuit of enforcement.

One can also imagine that ALJs plucked from relative obscurity at other agencies for a plum position at the SEC will feel especially beholden to the agency that hand-picked them—much more so than would an ALJ selected through the usual OPM selection process.

C. Avoiding the Appointments Clause Results in Less Expertise—Not More Independence—for ALJs

The myth that agency adjudication is conducted by experts appointed for their command of securities law does not withstand an examination of the facts. This Court should not balk at noticing that the expertise emperor has no clothes. Officers of the United States at SEC who were appointed pursuant to the Appointments Clause (*e.g.*, SEC Commissioners) have historically tended to bring relevant, pre-existing securities-law expertise with them to the agency. But when the Constitution's appointments process has been avoided, as with the appointment of ALJs at the SEC, those appointees have historically tended *not* to have relevant, pre-existing securities-law expertise. Hence, one can fairly conclude that ignoring the constitutional appointments process does not enhance the independence of ALJs; in-

stead, the trade-off is to reduce the relative expertise of such appointees (and the independence that subject-matter expertise brings) by deviating from the constitutional appointments process.

For these reasons this Court should not worry that disapproving the current ALJ appointment process will jeopardize the independence of ALJs at SEC. Far from it.

III. More Effective and Constitutionally Permissible Paths Exist to Securing Independent Judges in SEC Proceedings

Providing for independent judges in SEC enforcement proceedings is a worthy goal. But the current appointment process for ALJs does not further that end. So even if one thought that it were *possible* to interpret the Constitution in a manner that excludes ALJs as "officers of the United States"—and NCLA does not think this is possible, for the reasons provided by the petitioners and the Solicitor General—there is no *reason* to adopt this interpretation when the current regime fails to produce any semblance of independent adjudication.

The good news is that there is an effective (and constitutionally permissible) means of providing independent adjudicators—and it is hiding in plain sight in the language of the Constitution. Article III provides that the "judicial Power of the United States" shall be vested in the Supreme Court and in the "inferior courts" established by Congress, whose judges "shall hold their Offices during good Behaviour" and whose compensation "shall not be diminished during their Continuance in Of-

fice." U.S. Const. art. III. *This* is the mechanism that the Constitution provides for securing independent adjudicators in SEC enforcement proceedings.

Article III provides all that is needed to secure the independence of those who adjudicate SEC enforcement proceedings. Article III judges are principal officers chosen by the President and Senate together, rather than inferior officers selected by the SEC's Commissioners or mere "employees" selected by the SEC's chief ALJ. The decisions of Article III judges are never subject to review by the Commission, so they have no reason to conform their rulings to the SEC's wishes. And the Constitution gives Article III judges life tenure and protects their salaries from diminution, so Article III judges have no rational reason to fear ruling against the SEC.

Article III judges are also empowered to review the legality of SEC rules and statutory interpretations—unlike administrative-law judges, who are bound to follow SEC rules even if they believe them to be unlawful or unconstitutional. *See Arizona Grocery*, 284 U.S. 370. And as far as NCLA is aware, there have been no reports that contemporary Article III judges have ever felt pressured to rule in favor of administrative agencies. *Compare* Jean Eaglesham, *SEC Wins with In-House Judges*, Wall St. J. (May 6, 2015), http://on.wsj.com/1AKOxEH.

Article III judges enjoy added independence from their status as generalists. It is difficult, if not impossible, to pack the federal judiciary with either SEC or industry partisans, because the President and the Senate have many other priorities to consider when selecting

federal judges. In addition, political control of the Presidency and the Senate cycles over time between the two parties, which makes it even more difficult to consistently appoint Article III judges who show favor toward SEC enforcement efforts or the financial-services industry, or who hold any type of agenda with regard to the SEC.

Finally, the costs of replacing SEC ALJs with Article III judges are low. There are only five ALJs at the SEC, and the federal district courts can easily absorb a docket that is currently handled by five individuals. If there is to be truly independent adjudication in future SEC enforcement proceedings, then the solution is to move those proceedings to Article III courts, not to establish half-baked "independence" measures that flout the Constitution's appointment rules.

Meanwhile, this Court need not fear that any independence (or expertise) will be lost by disapproving the current SEC ALJ appointment regime. Hearings in front of ALJs at the SEC nowadays are neither impartial nor particularly expert.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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